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NOTES AND MEMORANDA.

THE CONTROVERSY ABOUT THE CAPITAL CONCEPT.

A theoretic problem which is especially engaging the present attention of economists is the exact and proper conception of capital as an economic term. The prevailing views on the subject are too well known to the readers of the Quarterly to require recapitulation here. I desire only to ask the careful attention of economists to a novel conception of capital, advanced by me in a recent publication,¹ which I believe to have some claim to be authoritative because of the manner in which it was reached.

It seems to me that the trouble with all the prevailing concepts of capital is that they have been sought by the inductive or empirical method. Each definer has endeavored to detect the bond which will synthesize the results of his individual observations. A certain evolution of concept—usually, to be sure, both tedious and uncertain—can be obtained by this method; but it rarely results in anything so definite and unequivocal as to command universal assent even from the competent. If we approach the problem by means of the deductive or analytic method, we recognize at once that capital is a means of production employed by the enterpriser. This is the genus of which it is a sub-class. What are the essentials for production? They can be divided into four distinct groups, and there are, therefore, four, and only four, distinct functions to be performed, and four factors, each performing one of these functions, and one only. An individual can indeed exercise several or all of these functions, and, as a matter of fact, must exercise at least two of them conjointly. The inductive process is practically forced to define the function in terms of the factor, because observation must always be

¹ Enterprise and the Productive Process. G. P. Putnam's Sons. 1907.

confined to the actions of individuals, not one of whom can confine himself to the exclusive performance of a single function. Factors can be directly observed, functions can only be inferred from observations of factors, where our only reliance is on the inductive method. The deductive process as naturally defines each factor in terms of its peculiar function because it distinguishes the factors solely by means of such radical differences in function as must necessarily segregate general actions into definite groups.¹

To obtain a material product, the first requisite is a purposeful or intelligent rearrangement of matter. This is effected by muscular force more or less intelligently directed. Secondly, we must preserve these rearrangements until such time as they are fitted for enjoyment,—*i.e.*, while they are “raw material,”—and after that until such time as they can afford either directly or indirectly a maximum enjoyment. Thirdly, we must avail ourselves of such facilities of production as we can appropriate from nature, invent, or create by rearrangements not directly useful. Fourthly, we must subject ourselves to the consequences of production. The first three furnish the means of production and enjoy respectively incomes of wages, interest, and rentals; all predetermined in amount because the furnishing of the means of production necessarily precedes production. Lastly, we have the enterpriser, who “as such” does not furnish a means of production, but subjects himself to its consequences and obtains an income of profit and loss (necessarily unpredetermined, because a consequence cannot precede the action). On the average, the result is a net profit, due to the fact that he refuses to so subject himself unless the probability of gain is substantially greater than the probability of loss.

Before deducing the true concept of capital from the above analysis of the productive process, it is essential that something more should be said here of the theory of Enterprise, as it is not yet fully adopted by the economic guild.

I first promulgated this theory in a criticism in these

¹ See the chapters on Method in Enterprise and the Productive Process.

pages¹ of Professor Böhm-Bawerk's work on Capital and Interest, the purport of my criticism being that the income he treated as interest was really a composite income, part interest and part profit. He brushed me to one side rather brusquely on the ground that I was evidently not familiar with his conception of profit. As a matter of fact, I was familiar with it, but disagreed with him, and still disagree. He evidently did not give my conception of Enterprise any serious consideration; and for this he is hardly to be blamed, as my first presentation of the idea was somewhat crude. Notwithstanding its crudeness, Professor Clark, on the other hand, was keen enough to see, and to state frankly, that I had pointed out a new and distinct form of income, and to that extent had made a valid contribution to economics. He refused, however, to consider the reward of risk or responsibility as a fundamental form of income, contending that it was only supplementary to interest because the capitalist was the only one who had anything to risk. I pointed out in rejoinder that it was necessarily the owner of the product upon whom the loss fell, and that, according to Professor Clark himself, the "ownership of the product" was necessarily the enterpriser's and not the capitalist's, and that the individual who made a loan always charged a premium over pure interest as an insurance. I further showed, I think conclusively, that an insurer was an enterpriser, and that, therefore, the lender of money at a rate in excess, of pure interest exercised the dual functions of capitalist and enterpriser, and that it was in the latter capacity that he suffered any loss that occurred or enjoyed as a profit any gain over pure interest that accrued to him as an individual. Other economists have evidently adopted my view of this particular instance, as most recent works treat the assumption of risks as a function of the entrepreneur, and some of them, notably Professor Fetter, have adopted the term "enterpriser," which I proposed as a substitute for entrepreneur because it carried with it the connotation of risk. Hardly anybody, on the other hand,

¹ Vol. vi., p. 280.

I regret to say, seems willing to regard the assumption of responsibility, the subjection to the results of production, as *the only* fundamental function of the enterpriser "as such." The conception of profit now prevalent seems to be that profit is the joint reward of management and responsibility, with the emphasis on management. Passing over for the moment the fact that a factor defined in terms of its function cannot have two fundamental functions, this seems to me very illogical. The plowman is the man who plows. His success as a plowman depends upon his skill in keeping his furrow straight, his selection of a plow fitted to the character of the soil, of horses of a strength and temper suitable for the work, and upon other causes too numerous to mention. But the logicians who insisted that "skill" or "judgment" was the fundamental peculiarity which distinguished the plowman from other men would be laughed at rather than argued with. Yet any one who will read the passage in Fetter's *Principles of Economics* (p. 291) will find this to be exactly the ground on which he rejects the theory that profit is the reward of the assumption of responsibility. He says, "Profits are due not to risks, but to *superior skill* in taking risks." In several other places in his book he speaks of profit as a "kind of wages," thus recognizing that the exercise of judgment is an act of mental labor. The term "enterpriser," which I first suggested and which Fetter adopts, means the one who makes himself responsible for an undertaking or venture. It is a synonym for the old-fashioned term "adventurer," but surely no one would define the adventurer as the man who was skilful in venturing. The rash and unsuccessful adventurer is as truly an adventurer as the more careful and skilful, or perhaps only more fortunate, one who succeeds. It is the one fundamental fact that he ventures that makes a man an enterpriser. It is what a man does, and not how well he does it, that defines the function he exercises. It is plowing, and not how well he plows, that makes a man a plowman. No one ever presumed to claim that "efficiency" or "judgment" is the fundamental char-

acteristic of the laborer which differentiates him from other men. Why, then, should it be insisted that they are the fundamental characteristics of the assumer of responsibility? Surely, wages are due to skill in exactly the same sense that profit and loss are.¹

This recapitulation of the theory of enterprise is necessary here for two reasons. One is that, if my views are correct, economists confuse profit sometimes with rent, sometimes with interest, and even sometimes with wages: the other is that the function of the capitalist and the origin of interest are determinable only from the view-point of enterprise. It is only when we have elucidated what need of the enterpriser the capitalist supplies that we can discover just what he effects in production. The function of the capitalist is passive, not active. It is not what he does, but what he refuses to do, that obtains him an income of interest. He simply refrains from exercising a certain amount of the purchasing power which has come into his possession as wages, interest, rent, or profit. In the typical case this power comes only in the shape of money; that is, only as a claim on commodities in general. When it happens to become embodied in commodities, he necessarily acts not only as a capitalist, but, so long as he retains the commodities, as an enterpriser as well, because he is then subjected to the uncertainties of actual possession. If he lends these actual commodities to be repaid in money, he escapes the involved uncertainties, but preserves his claim, not on the commodities parted with, but on commodities in general. His usual and typical course, however, is to sell the commodities and then lend his general claim. The crucial point is that the capitalist "as such" cannot invest his own capital. Investment is strictly incident to enterprise. It is the very act of subjecting capital to the uncertainties inherent in actual ownership

¹It will of course be understood that in selecting Fetter's treatment of profit and enterprise for criticism I am using him merely as the representative of the prevailing mode of thought on the subject. As a matter of fact, I find myself in closer accord with his views on economics than with those expressed in any other general treatises on the subject with which I am familiar.

of "capital goods." The active part of preserving capital is incidental to enterprise. Retaining the "capital goods" in which capital is embodied, whether such "capital goods" are computed by quantity or value, is rewarded not by interest, but by rent or profit accordingly as the "capital good" is a facility or a consumable commodity; accordingly, that is, as it is withheld from the market for use or retained for the purpose of being ultimately sold,—held for a market. The passive part of preserving capital is simply allowing it to persist by refraining from purchasing any of the commodities in which capital is embodied.

From this it follows that what the capitalist lends is unexpended purchasing power, an unexpired claim on things in general. The only proper conception of capital is therefore that it is an aggregate or flow, according to the aspect in which we consider it, of unexpended purchasing power,—unexpended, that is, by the capitalist "as such,"—or, in other words, an aggregate or flow of unexpired claims on valuable things in general. It is only by a metaphor that capital in any sense of the term can be said to earn interest. It is the capitalist who earns interest by refraining, just as the laborer earns wages by laboring, the landlord or appropriator rent by allowing others to utilize his special facilities, and the enterpriser profit by retaining. Matter cannot earn: earning is possible only to intelligent beings acting with a purpose.

Now it seems, to me at least, that this conception of capital is just what Professors Clark, Fetter, and Fisher (who, I notice, are being classed together as the "new economists") have been feeling for. Intuitively dissatisfied with the old concept which identified it with "capital goods," they have sought to amend it by the inductive or empirical process which I have criticised in my recent book. They got no further than they did because their refusal to accept the assumption of responsibility as the distinguishing and fundamental peculiarity of the enterpriser's function makes it impossible to discriminate interest from other forms of income. The concept of capital I

am here advocating is not a development of their ideas, altho it seems to be the goal towards which they were tending. I was familiar of course with Clark's distinction between "capital goods" and what he called "true capital," but I am not aware that it consciously influenced the development of my own concept. The recent works of Fetter and Fisher I had not read until after my own book was written. My own conception was obtained deductively in accordance with the principles of deductive classification to which I have called attention in that book.

Now, if mine is the true concept of capital, "capital" has nothing at all to do with "capital goods" so far as the capitalist himself is concerned and so far as it is the earner of the income called interest. This concept is not open to a single one of the criticisms which Böhm-Bawerk applies to Clark's conception, and also, by implication, to those of Fetter and Fisher. There is no time or space left to show this in detail; but that surely is too evident to be necessary. Somewhat curiously, if the concept is accepted as correct, it shows that, while neither party to the controversy has proved his case, the intuitions of both were true. Clark's intuition is that interest cannot be explained in connection with "capital goods," and Böhm-Bawerk's is that "time" is the essential thing in the problem of interest. According to my conception it is the possibility of establishing "relations of time" that the capitalist furnishes to the enterpriser, and it is literally "relations of time" that earn interest.

Do not the difficulties with which economists are struggling, not only those relating to capital and interest, but also those relating to the two other factors and their incomes and functions, arise from their so persistently ignoring the theoretic importance of the fourth factor—enterprise—and its function? Elsewhere I have endeavored to show that this factor stands on an entirely different footing from the others. While it belongs with them to the same genus (sharers of income), it is not a member of the sub-genus, means of production, but belongs to the

co-sub-genus, purpose of production, of which it is the only member. The purpose of every human thought or action, individualistic, social, or economic, of every volition, is betterment. But betterment is the difference between cost and result, and this difference is necessarily an undetermined residue, which is the definition of profit. Their propelling motive is surely the best point of view for studying economic activities. When we seek therefore to learn just what the enterpriser requires in order to obtain the product, the true theory of the factors and their functions unrolls itself. He must effect changes in the form and place of material things. The physical force to do this is supplied by manual labor, and the intelligence or management which guides this force by mental or psychical labor; and those who sell him these rearrangements of matter and of ideas earn wages. Secondly, he must have the ability to preserve the changes labor effects until the products in which the changes are embodied are sold, or while they are being utilized as facilities. This ability is furnished by refraining from consumption,—by the refusal of some one to exercise the purchasing power he commands. It is simply this refraining which is the function of the capitalist, and by which interest is earned by the capitalist. Retaining is an incident of the function of the enterpriser, and has nothing to do with interest. The problem of capital and interest cannot be solved from the standpoint of investment, which is that not only of Böhm-Bawerk, but also of Clark, Fetter, and Fisher. Investments are made by the enterprisers and not by the capitalists, and have absolutely nothing directly to do with the problem of interest, and nothing indirectly except that the enterpriser will not make investments that do not promise a satisfactory profit after interest cost is satisfied. Investment bears exactly the same relation to interest that it does to wages,—to it both are costs. Wages are paid to induce laborers to do what they had rather not do: interest is paid to capitalists to induce them to refrain from doing what they had rather do. The only

further important theoretic difference between wages and interest is that the thing the laborer is induced to do is a specific thing, whereas the thing which the capitalist is induced not to do is not specific. Doing must always be objective,—have a specific thing to deal with. Not doing may be subjective and relate to no specific thing, but only to things in general. It is for this reason that wages vary in accordance with the specific thing accomplished, whereas the rate of interest varies only from general causes. The trouble with the problem of capital and interest has been that economists have insisted upon investigating it from the standpoint of retaining instead of from the standpoint of refraining, when they have not treated it from both standpoints at once without recognizing any difference between them. This is inevitable so long as it is denied that ownership or retaining, with its attendant risks and responsibilities, is the very essence of the enterpriser's function. The problem of capital and interest will never be settled by any one who persists in regarding profit, with Fetter, as the "wages of management," or, with Clark, as an income supplementary to interest; or by those who, in common with the great body of economists, define functions in terms of their factors instead of factors in terms of their functions.

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